Supreme Court of the United States

OCTOBER TERM 1942

No. 551

IN THE MATTER

OF

JOHN M. RUSSELL, INC.,

Bankrupt.

ALLAN D. EMIL, as Trustee in Bankruptcy of
JOHN M. RUSSELL, INC.,

Appellant,

HARRY HANLEY, Receiver,

Appellee.

BRIEF OF RESPONDENT IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

JOHN P. McGRATH,
Attorney for Harry Hanley, as Receiver.

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The Circuit Court affirmed, by a divided court, an order of the United States District Court for the Eastern District of New York denying petitioner's application for an order requiring the respondent as receiver of the rents and profits of a parcel of real estate owned by the bankrupt, to file his account with the Bankruptcy Court. The receiver was appointed by the New York Supreme Court in an action brought to foreclose a third mortgage on the real estate.

The Facts

The opinion of Judge Learned Hand contains an accurate statement of facts which will not be here repeated.

The Issues

The record below presented the following issues for review:

1. Did the District Court err in assenting to the retention of jurisdiction by the State Court to settle the receiver's account and in acquiescing in the determination of the State Court after a full and complete hearing on the merits,

2. Do the provisions of Section 2(a)(21) and Section 69(d) of the Bankruptcy Act require that a receiver of the rents and profits, appointed by a State Court, in an action to foreclose a specific parcel of real estate owned by the bankrupt, must account in the Bankruptcy Court even though the State Court is not superseded insofar as the continuance of the foreclosure suit is concerned.

No constitutional question is involved but merely the interpretation of Section 2(a)(21) and Section 69(d) of the Bankruptcy Act.

POINT I

The order of the District Court must be sustained as an exercise of discretion.

The petitioner takes the position that, if Sections 2(a)(21) and 69(d) be construed as applicable to a receiver of the rents and profits in a state foreclosure proceeding relating to a specific parcel of real estate owned by the bankrupt, then the order of the District Court and the affirmance by the Circuit Court of Appeals are both erroneous and this petition should be granted in order that the orders may be reversed.

The case presents no such clear cut issue. We submit that even if the petitioner's construction of the statutory provisions be upheld, th order of the District Court should not be reversed. That order was not *solely* predicated upon the inapplicability of the two statutory provisions to receivers of the rents and profits. It was predicated rather upon the exercise of the discretion of the Bankruptcy Court in giving its consent and approval to the exercise of jurisdiction by the State Court and to the determination made by that court after a full hearing on the merits.

The legal interpretation of Sections 2(a)(21) and 69(d), while interesting, is academic so far as the order of the District Court is concerned. That order cannot be reversed except on a finding that the District Court abused its discretion in consenting to the exercise of jurisdiction by the State Court and acquiescing in the determination of that court.

The District Court did not immediately act on the petitioner's application to compel the receiver to account in the Bankruptcy Court. The motion was made on August 15, 1941 (fol. 46). The District Judge at the time of argument stated that he was inclined to permit the State Court to retain jurisdiction (fol. 47). The motion was decided February 10, 1942 (fol. 60). In the meantime the accounting proceeding was fully tried and determined in the State Court and an order was made settling the account on December 3, 1941 (fols. 48-49). Thereafter the District Judge asked for further affidavits (fols. 50, 34). From these affidavits he concluded: "It is evident that the issues raised by the trustee were fully tried and a determination was made on the merits" (fol. 54).

The Court then assented to the determination of the State Court in the following language (fols. 55-56):

> "Considering the two sections of the Bankruptcy Act cited by the trustee, it appears that in the event

> that this court granted the trustee's motion, the receiver's accounting would be filed and the same objections would be interposed by the trustee. This would afford him two trials of the same issues already determined in the Supreme Court of the State of New York. A fair interpretation of the Bankruptcy Act leads to the conclusion that it was not intended to give two trials of the same issues. As was said In Re National Motorship Corp. (96 Fed. (2) 88 ' ' ' ' state court's disposition was subject to assent of the Bankruptcy Court' indicating that full faith and credit can therefore be given by this court to the determination of the Supreme Court of the State of New York."

We construe the quoted language to mean that the District Court predicated its decision on the assumption that it had the power, under the statutory provisions relied on, to direct the receiver to account in the Bankruptcy Court, but withheld the exercise of that power, being satisfied that the proceedings in the State Court were proper and that the rights of those interested in the bankrupt estate had been safeguarded and protected. Under this decision the petitioner cannot be heard to complain that the court misconstrued the statute. His only ground for a reversal would be a possible abuse of discretion by the District Judge. Not only does he not make such a claim but he should certainly not be permitted to invoke the jurisdiction of this Court merely to review the exercise of such discretion.

The right of the Bankruptcy Court to consent to the exercise of jurisdiction by the State Court is well established.

> *In re National Motorship Corp.*, 96 Fed. (2) 88.
> *In re American Fidelity Corp. Ltd.*, 28 F. Supp. 462.
> *In re Canyon Pipe Line Co.*, 39 F. Supp. 233.
> *Wells* v. *California Tomato Juice, Inc.* (D. C. of Appeals, 3rd D. Cal., 1941), 118 F. (2) 916.

Even where the petition in bankruptcy antedates the foreclosure, and the jurisdiction of the Bankruptcy Court is clearly paramount (*Isaacs* v. *Hobbs Tie & Timber Co.*, 282 U. S. 734), it has become frequent practice for mortgagees of real property, upon the happening of a default, to apply to the Bankruptcy Court for leave to institute foreclosure proceedings in the State Court. Such applications are granted with great frequency, the court generally requiring a further application to be made for consent of the Bankruptcy Court to the entry of judgment of foreclosure and sale in the State Court. In this way the Bankruptcy Court does permit the exercise of jurisdiction in the courts of the state and at the same time retains sufficient control to prevent the entry of judgment if the circumstances should require that the entry of judgment be withheld.

The District Court in this case was content to limit its exercise of jurisdiction to the *supervision* of the settlement of the account by the State Court. In so doing the court was fortified by ample precedent and it cannot be said that the objectives sought to be attained by the statutory amendments were not achieved.

It is not the spirit or the policy of the bankruptcy statute or the 1938 amendments thereto to proscribe completely the exercise of any jurisdiction by a State Court. The recent decision of this Court in *Marine Harbor Properties Inc.* v. *Manufacturers Trust Company* (decided November 9, 1942) supports the view that a State Court, having acquired prior jurisdiction, should not be precluded from protecting the rights of senior creditors where it is not shown that the continued exercise of such State Court jurisdiction would prejudice other interested parties. It cannot be said on the record in this case that the District Court was not satisfied that the settlement of the receiver's accounts in the State Court did substantial justice to those interested in the bankrupt estate.

POINT II

The bankruptcy proceeding did not supersede the State Court foreclosure; in the absence of such supersession, the State Court receiver was not displaced.

Where the State Court has acquired control of property by the commencement of foreclosure proceedings prior to the filing of a petition in bankruptcy, the Bankruptcy Court will not enjoin the continuance of such proceedings.

In re Maier Brewing Co., Inc., 65 Fed. (2) 673.
Stratton v. *New*, 283 U. S. 318.

It is only where the proceedings are commenced in the State Court after the filing of the petition in bankruptcy that the Bankruptcy Court will enjoin such proceedings and assert its paramount jurisdiction.

Isaacs v. *Hobbs Tie & Timber Co.*, 282 U. S. 734.

The following quotations from the majority opinion in the Circuit Court of Appeals are apposite:

R., p. 27:

> "Before the addition of section 2(a)(21) and section 69(d) there was therefore no doubt that the jurisdiction of the Bankruptcy Court over foreclosure receivers—including the power to pass their accounts—depended upon the petition being earlier than the suit."

R., p. 28:

> "the rents are security just as the land is security from the time when the court intervenes; they become part of the mortgaged *res* because only so can the mortgagee be protected during the inevitable delay."

R., p. 28:

> "Either the bankruptcy should supersede the whole suit, as it does in the case of a winding up, or it should not touch it at all; the tail goes with the hide."

Upon the happening of a default and the appointment of a receiver in foreclosure the rents are just as much security for the debt as the real estate itself. This is a customary provision of all mortgages in New York State and expresses the state law.

Sullivan v. *Rosson*, 223 N. Y. 217.

To sustain the contention of the petitioner is to assert the unheard of doctrine that upon the filing of a petition in bankruptcy, there is effected a severance of the rents from the real estate, the State Court losing control of the rents to the Bankruptcy Court while retaining control of the real estate. The majority opinion observes that insofar as "straight bankruptcy" is concerned this would be a "revolutionary change" (R., p. 31).

The rents in the hands of the receiver never came into the possession, actual or constructive, of the Bankruptcy Court. Whatever title the trustee in bankruptcy acquired to either the rents or the real estate was subject to the ultimate outcome of the foreclosure proceeding with which the property was burdened at the time the petition was filed. Since the bankruptcy did not supersede that foreclosure proceeding, the property and its income remained in the custody of the State Court until completion of the foreclosure. Moreover, the trustee had to await the outcome of the State Court proceeding in order to determine whether the entire value of the property was required to satisfy the debt which it secured or whether there would be a surplus over and above the amount required to satisfy the debt. Until the surplus was determined, there was nothing which the bankruptcy trustee could claim. When it developed that there would be a surplus of rents in the

hands of the receiver the trustee was only one of several adverse claimants to such surplus. These rents were part of the *res* over which the State Court acquired prior jurisdiction and that court had the exclusive power to settle any controversies with relation thereto.

Dannel v. *Wilson-Weesner-Wilkinson Co.*, 109 Fed. (2) 364.

In re American Fidelity Corp., Ltd., 28 F. Supp. 462.

POINT III

The decision of the court below is not in conflict with any other decision cited by the petitioner.

The petitioner makes the point that the decision of the court below is in conflict with *Matter of Park Beach Hotel Building Corp.* (96 Fed. [2] 886), *In re Rosenberg* (128 Fed. [2] 924), and *Matter of Central Forging Co.* (31 F. Supp. 1038), and urges that this Court grant the petition in order that the seeming conflict may be resolved.

There is no conflict. The basic difference between the case at bar and the alleged conflicting cases is that the former is a "straight bankruptcy" case, whereas the others are reorganization cases. Both the majority and minority opinions below recognized this basic difference.

The prevailing opinion, in speaking of the difference between ordinary bankruptcy on the one hand and a "plan" under Chapter 10, or an "arrangement" under Chapter 12, on the other, states as follows (R., p. 29):

> "there is nothing anomalous or inconsistent in saying that section 2(a)(21) when applied to proceedings under these chapters includes foreclosure receivers, but does not when applied to 'straight bankruptcy'—liquidation. Since the section merely grants a new remedy and was not intended to enlarge the jurisdiction of the Bankruptcy Court, the distinction was

one which we should expect and which was indeed necessary. This is so because even as to valid mortgages and other liens, proceedings under these chapters are supersessive, just as 'straight bankruptcy' is supersessive as to state insolvency proceedings or 'equity receiverships'."

The dissenting opinion states (R., p. 38):

"In ordinary bankruptcy, to be sure, Congress has left secured property outside the distribution of hierarchy."

In *Matter of Park Beach Hotel Building Corp.* (supra) the debtor filed a petition for reorganization, not an ordinary bankruptcy petition. Upon the filing of the petition, the foreclosure receiver surrendered possession of the property to the trustee. In that case there could be no question of conflicting jurisdiction between the Bankruptcy Court and the State Court for admittedly the reorganization proceeding superseded the State Court foreclosure and the State Court receiver, recognizing such supersession, surrendered possession of the real estate. In the case at bar there was no supersession upon the filing of the petition in ordinary bankruptcy and there was no surrender of the property to the Bankruptcy Court by the receiver. These distinguishing elements conclusively demonstrate that there can be no real conflict in statutory interpretation as between the two cases.

The petitioner argues that had the *Park Beach Hotel Building Corp.* case been presented to the court below that court would have decided it differently than the Seventh Circuit Court did. We disagree. The reasoning of the prevailing opinion of the court below persuades us that that court would have decided the *Park Beach Hotel Building Corp.* case exactly as the Seventh Circuit Court decided it.

Matter of Central Forging Co. (31 F. Supp. 1020), likewise cited by petitioner as being in conflict, is similarly

distinguishable because it was a reorganization proceeding and not an ordinary bankruptcy proceeding looking toward liquidation.

CONCLUSION

The application for writ of certiorari should be denied.

Respectfully submitted,

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